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C O N F I D E N T I A L SECTION 01 OF 04 TEGUCIGALPA 002046

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STATE FOR EB/IFD, WHA/EPSC, INR/IAA, DRL/IL, AND WHA/CEN
TREASURY FOR AFAIBISHENKO
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TAGS: [ECON](#) [EFIN](#) [PGOV](#) [SOCI](#) [HO](#)

SUBJECT: HONDURAS: MIN FIN SEEKING DONOR SUPPORT AND MORE
DEBT FORGIVENESS

Classified By: Ambassador Charles Ford for reasons 1.4 (b) and (d)

¶1. (C) Summary: In an October 23 meeting with Ambassador, Minister of Finance Rebeca Santos asked for additional technical assistance to assist her ministry in improving fiscal administration and oversight and increasing transparency. She also renewed her request for technical assistance in budget formulation and implementation. Santos denied that the Ministry of Finance is responsible for slow project implementation, blaming that on the political choice by the Zelaya Administration to focus on current spending instead, and on the slow and overly bureaucratic procedures of the international financial institutions. She said she is pleased with her relations with the IMF, but asked donor governments to pressure President Zelaya to return to fiscal responsibility, since he "does not always listen" to his ministers. Despite declarations from President Zelaya discounting any possibility of electricity rate hikes, Santos supports such rate hikes to return the state-run electricity company profitability. She asks the international donor community to press this issue with Zelaya. GOH fiscal discipline -- the pre-requisite for previous debt relief -- has eroded significantly under the new Zelaya Administration, yet the GOH continues to seek new debt relief from the Interamerican Development Bank (IDB). Post would not support such a request until the GOH could demonstrate a renewed commitment to fiscal discipline, including by receiving a passing grade from the IMF. Finally, on the issue of establishing and funding the new Competition Commission, vital to combating corruption and monopolistic collusion in Honduras, Santos disappointed by exhibiting a distrust of the agency and an unwillingness to provide sufficient funds for it to begin full operations. Instead, she requests that, once again, the international donors pick up the tab. End Summary.

¶2. (SBU) In an October 23 call on Ambassador, Minister of Finance Rebeca Santos expressed satisfaction with her relations with the International Monetary Fund (IMF) but sought additional technical assistance from the USG and other donors to improve fiscal administration. She seeks better fiscal "clarity," and sees her goals as including harmonizing policies in the region to attract investment and create jobs while rooting out unfair competition.

More Technical Assistance, Please

¶3. (SBU) On the subject of USG-supplied technical assistance, Santos lamented the loss of a resident U.S. Treasury Advisor on tax matters, and intends to raise this issue with Treasury Assistant Secretary Lowery during his proposed November 8 visit. She found the former Treasury advisor to be an excellent source of objective advice, particularly on questions of improving tax collections.

¶4. (SBU) Santos also renewed the GOH request for Treasury OTA assistance on budget preparation and implementation. A Treasury OTA budget team visited Honduras earlier this year, but the proposal has not advanced since then. Santos referred to improving budget preparation and oversight as "extremely important" for her, as she is quite concerned over the lack of discipline imposed on Ministries regarding budget execution. In one recent case, the Minister of Health was sacked when it was learned he had wildly exceeded his budgeted authorizations by hiring hundreds of contract workers, largely to satisfy political pressures for patronage. Santos seeks help in auditing both that Ministry and the Ministry of Education, to see just how bad the damage is. Privately, Santos called President Jose Manuel "Mel" Zelaya Rosales' recent decision to yield to teacher's demands for massive wage hikes (a violation of the IMF agreement) "totally irresponsible." She asked for support from the donor group (known as the G-16) in pressing for an audit of the funds and these positions. (Note: The USG, as President pro tem of the G-16, supports Santo's suggestion if combined with genuine and substantial reforms to the educational system. End Note.)

Slow Capex is a Political, not Technical Problem

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¶5. (C) Pushing back against recent criticisms that the Ministry of Finance is slow in implementing spending priorities, Santos rhetorically asked, "If SIAFI (the Integrated Financial Administration System) works so well for current spending, why does it not work for investment spending?" The answer, she said, is that SIAFI is working well, but political choices have been made within the GOH to focus on current spending and not investment spending.
(Comment: Some would argue with her assertion that SIAFI is functioning smoothly, but her point that the GOH has focused on current spending to the detriment of longer-term investment is a view widely shared throughout the donor community. End Comment.)

¶6. (C) Santos also laid some of the blame at the feet of the multilateral financial institutions, complaining of significant bureaucratic delays in refocusing projects and approving disbursements. She also criticized them for relying too much on independent Project Implementation Units embedded within Ministries, rather than using the technical capacity of the Ministries to conduct oversight. The GOH Social Investment Ministry (FHS) particularly suffers from this, and its minister, Presidential-hopeful Marlon Lara, finds the current arrangement "unmanageable." (Comment: Lara has been criticized severely in the press for this and other organizational difficulties, possibly in the run-up to a rumored December Cabinet reshuffle. Many view this as a precursor to firing him, as a means of diminishing his stature prior to the 2009 elections. During his 12 years as mayor of Puerto Cortes, Post found him engaging, intelligent, and an accomplished manager, and can easily see why other Liberal Party stalwarts might view him as an electoral threat. End Comment.)

Greater Transparency, Sooner Rather Than Later

¶ 7. (SBU) Santos also supports greater transparency by the GOH, with or without the long-awaited Transparency Law, which is still stuck in the bureaucracy. Santos wants to expand the information contained on the Ministry's website, and make it more accessible to the public. She is also calling for a web portal that would link all information on upcoming government procurements, to make such information easily accessible to potential suppliers both inside and outside Honduras. That portal would be administered by the Ministry of the Presidency and supported by MinFin and others (such as the Public Works Ministry) that host such bid solicitations.

Content with the Fund, But is the Fund Content?

¶ 8. (C) Santos said she is "very content" with her relations with the IMF, citing an open and continuing dialogue. An IMF Article IV Team is expected to visit Honduras from November 6-20, to review the state of fiscal affairs in preparation for negotiations over a proposed Policy Support Instrument (PSI). The PSI would carry all the conditionalities of the current Poverty Reduction and Growth Facility (PRGF), which expires in February 2007, but does not include financial support. However, the IMF was unable to close the fourth review of the PRGF in May 2006, indicating significant concerns over current fiscal policies and priorities. Post has reported extensively on these concerns, and the widely held view that, were the Fund to be forced to make a declaration, it would have to find the GOH is off-track (that is, out of compliance) with its PRGF commitments. Santos did not address the GOH's significant challenges going into the upcoming IMF review. She did, however, say that she is "urging the President to pay more attention to the IMF." However, she said, "the President does not always listen to me." She therefore asked that the donor community continue to keep pressure on the GOH to return to a policy of fiscal discipline.

¶ 9. (C) On the key issue of parastatal telephone company Hondutel's declining revenues, Santos said the solution is simply a rebalancing of rates (echoing the advice of previous

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IMF missions.) Regarding the much more severe losses at parastatal electricity company ENEE, Santos said Honduras "needs to face reality." The GOH should eliminate untargeted subsidies to consumers, and should be prepared to raise electricity rates. This politically explosive but fiscally realistic view runs contrary to the very clear statements emanating from the Presidency that electricity rate increases will not even be considered. Asked how the GOH could please the Fund if a rate hike is off the table, Santos again turned to the donor community for support, saying that everyone "needs to keep pushing" the GOH to do the right thing.

Seeking More Debt Relief; But Where Did the Last One Go?

¶ 10. (C) The GOH continues to seek additional debt relief, in this instance from the Interamerican Development Bank (IDB). The IDB debt was not included in the debt relief package contemplated under the Heavily Indebted Poor Countries (HIPC) debt relief initiative, for which Honduras qualified in 2005.

Since reaching Completion Point, Honduras has received approximately USD 2.8 billion in debt relief, which it committed under terms of the agreement to dedicate to poverty reduction activities. The GOH has a fully-developed Poverty Reduction Strategy, but complaints abound that few disbursements are being made under this program. Instead, it is widely believed that GOH spending is focusing on non-productive but popular subsidies to consumers such as gasoline price freezes, salary hikes for teachers, and subsidies for electricity. The GOH failed for ten months to

present required reports to Congress on this spending, and only on October 13 did it present its first report to the Group of 16 (G-16) of donor nations and institutions. The G-16 will study this information and request additional data from the GOH in the coming weeks.

¶11. (C) Despite the fact the GOH increasingly appears to be out of compliance with its IMF commitments and cannot demonstrate that it has met the HIPC debt-relief requirement to spend those funds on poverty reduction, Santos believes Honduras merits the additional IDB debt relief requested. So far, IDB members Mexico and Brazil have reportedly blocked creating a debt relief mechanism within the IDB, while the USG supports it. (Comment: Should such a debt relief mechanism be created, Post is of the strong opinion that Honduras should be evaluated for any debt relief based on its current economic performance. Since Zelaya assumed office on January 26, 2006, Post has observed declining GOH fiscal discipline and increasing recourse to populist, short-term measures. To provide debt relief under such circumstances would be to reward bad behavior. It would be better to condition future relief, as was the case with the original HIPC relief, on fiscal performance, including performance under its agreements with the IMF. End Comment.)

Little Moral or Financial Support for New Anti-Trust Agency

¶12. (C) On funding the newly formed Competition Commission (roughly analogous to the U.S. Federal Trade Commission), Santos disappointed by taking a fairly unsupportive stance. "My gut reaction," she said, "is to fight the formation of any new bureaucracy." She said the Commissioners, who seek salaries equivalent to those paid to the Commissioners of the Banking and Securities Commission, are asking for too much. Santos also noted that she has funded only half of their relatively modest request for funds to hire staff and set up an office. EconChief pointed out that high-quality staff that are above reproach are needed if the commission is to remain uncorrupted, and such staff do not come cheap. Furthermore, we pointed out, the commission has a mandate to begin operations by December, and yet it does not even have a staff or offices yet, some eight months after the bill creating the commission was passed. In reply Santos expressed her confidence that donors would once again assume the responsibilities the GOH is unwilling to assume, and pay the lion's share of the effort to fight monopolies and other forms of unfair competition.

¶13. (C) Comment: Minister Santos clearly looks to the

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international donor community to communicate hard messages to President Zelaya. The GOH may increasingly look to donor funding to fill gaps in investment spending, allowing the GOH to spend its resources (including funds freed from debt servicing) on politically expedient programs that largely fail to reduce poverty. We will continue to work with Minister Santos and also through the G16 to preach the message of fiscal discipline, and urge Washington agencies to encourage the IDB to review the economic performance of the Zelaya administration as a part of any debt forgiveness discussion. Minister Santos says she would like to foster a more competitive economy, but it is difficult to reconcile that goal with her mistrust of the anti-trust commission established to foster competitiveness in a traditionally monopolistic and collusive business sector. End Comment.

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